

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF TEXAS
LUFKIN DIVISION

UNITED STATES ex. rel.
HARROLD E. (GENE) WRIGHT

% Verner, Liipfert, Bernhard, McPherson
and Hand, Chartered
1111 Bagby, Suite 4700
Houston, Texas 77002

and

% Welch & Tunnell
P.O. Box 1574
Lufkin, Texas 75402

BRINGING THIS ACTION ON BEHALF
OF THE UNITED STATE OF AMERICA

% J. Michael Bradford
U.S. Attorney for Eastern District of Texas
350 Magnolia Avenue, Suite 150
Beaumont, Texas 77701-2237

and

% Janet Reno
Attorney General of the United States
U.S. Department of Justice
10th & Constitution Avenues, N.W.
Washington, D.C. 20530

vs.

AGIP Petroleum Company Incorporated;
Amerada Hess Corporation; Amoco
Production Company; Anadarko Petroleum
Corporation; Anadarko Production Company;
ANR Production Company; The Anschutz
Corporation; Apache Corporation; Ashland
Oil, Inc.; Atlantic Richfield Company; B.T.

SECOND AMENDED
ORIGINAL COMPLAINT

Date Received and
Placed Under Seal

FILED
U.S. DISTRICT COURT
EASTERN DISTRICT OF TEXAS

APR 2 1998 *CK*

DAVID J. MALAND, CLERK
BY
DEPUTY *Cassidy Kellen*

JUDGE JOHN H. HANNAH, JR.

~~SEAL~~

UNSEALED
3-28-00

CIVIL ACTION NO. 9-98CV30
(Originally filed August 2, 1996
as Civil Action No. C-5:96CV243)

Operating Company; Basin Exploration, Inc.;	§
Bass Enterprises Production Company; BP	§
Exploration and Oil, Inc.; BP Exploration	§
(Alaska), Inc. f/k/a Sohio Alaska Petroleum	§
Company; Bridge Oil Production Company;	§
Cabot Petroleum Corporation; Canadianoxy	§
Offshore Production Co.; Chevron U.S.A.,	§
Inc.; CNG Producing Company; Coastal	§
Oil and Gas Corporation; Coastal Oil and	§
Gas U.S.A., L.P.; Conoco, Inc.; DEK	§
Energy Company f/k/a DEKALB Energy	§
Company; Delmar Operating, Inc.; Elf	§
Exploration, Inc.; Energy Development	§
Corporation; Enserch Corporation;	§
Enserch Exploration, Inc.; Enserch	§
Offshore, Inc.; Equitable Resources	§
Energy Company; Exxon Corporation;	§
Fina Exploration, Inc.; Fina Oil &	§
Chemical Company; Forcenergy, Inc.	§
f/k/a Forcenergy Gas Exploration, Inc.;	§
Forest Oil Company; Freeport-McMoran,	§
Inc.; Freeport-McMoran Oil & Gas	§
Company; Hall-Houston Oil Company;	§
Hamilton Brothers Corporation; Hamilton	§
Brothers Exploration Company; Hamilton	§
Brothers Oil Company; Helmerich &	§
Payne, Inc.; Home Petroleum Corporation;	§
Houston Oil & Minerals Corporation;	§
Howell Petroleum Corporation; Hunt Oil	§
Company; Hunt Petroleum Corporation;	§
Kerr-McGee Corporation; Kirby	§
Exploration Company of Texas; Koch	§
Exploration Company; Koch Industries, Inc.;	§
Louis Dreyfus Reserves Corp.; The Louisiana	§
Land & Exploration Company; LLECO	§
Holdings, Inc.; LLOXY Holdings, Inc.;	§
Marathon Oil Company; McMoran Oil &	§
Gas Company; Meridian Oil, Inc.; Meridian	§
Oil Production, Inc.; Mesa Operating	§
Limited Partnership; MidCon Exploration	§
Company; MidCon Offshore, Inc.; Mitchell	§
Energy Corporation; Mobil Oil Corporation;	§
Mobil Oil Exploration and Production; Mobil	§

Exploration and Producing North America,	§
Inc.; Mobil Producing Texas & New Mexico,	§
Inc.; Mobil Oil Exploration & Producing	§
Southeast, Inc.; Mosbacher Energy Company;	§
Mosbacher Offshore, Inc.; Murphy	§
Exploration & Production Company;	§
Newfield Exploration Company; Norcen	§
Explorer, Inc.; Nuevo Energy Company;	§
Oxy U.S.A., Inc.; Oryx Energy Company;	§
Pacific Offshore Co.; Parker & Parsley	§
Petroleum Company; Pennzoil Company;	§
Pennzoil Exploration and Production	§
Company; Pennzoil Petroleum Company;	§
Petrofina Delaware, Inc.; Petrofina	§
Exploration, Inc.; Petro-Hunt Corporation;	§
Phillips Petroleum Company; Placid	§
Oil Company; Pogo Gulf Coast, Ltd.;	§
Pogo Producing Company; Questar Oil	§
and Gas Company; Quintana Energy	§
Corporation; Quintana Offshore, Inc.;	§
Quintana Petroleum Corporation;	§
The Rosewood Corporation; Rosewood	§
Resources, Inc.; Rowan Companies, Inc.;	§
Rowan Petroleum, Inc.; Samedan Oil	§
Corporation; Santa Fe Energy	§
Resources, Inc.; Shell Consolidated	§
Energy Resources, Inc.; Shell Frontier	§
Oil & Gas; Shell Gas Pipeline	§
Company; Shell Land & Energy	§
Company; Shell Offshore, Inc.;	§
Shell Oil Company; Shell Pipe Line	§
Corporation; Shell Western E & P, Inc.;	§
Snyder Oil Corporation; Snyder Oil	§
Partners, L.P.; Snyder Operating	§
Partnership, L.P.; Southwestern	§
Energy Production Company; Sun	§
Operating Limited Partnership; Taylor	§
Energy Company; Tenneco Gas	§
Production Corporation; Tenneco Oil	§
Company; Tesoro Petroleum Corporation;	§
Texaco Exploration and Production, Inc.;	§
Texaco, Inc.; Torch Energy	§
Associates, Ltd.; Torch Operating Company;	§

Transco Exploration Company; Union	§
Pacific Resources Company; UNOCAL	§
Corporation; Union Oil Company	§
of California; Union Texas Petroleum	§
Corporation; Valero Energy Corporation;	§
Valero Producing Company; Vastar	§
Resources, Inc.; Walter Oil & Gas	§
Corporation; Zapata Corporation; and	§
Zapata Exploration Company; and their	§
respective divisions, subsidiaries and	§
affiliates	§

**SECOND AMENDED COMPLAINT FOR DAMAGES AND OTHER
RELIEF UNDER THE FEDERAL FALSE CLAIMS ACT**

Plaintiff-Relator Harrold E. (Gene) Wright ("Relator"), who brings this *qui tam* action in the name and on behalf of the United States of America as well as on his own behalf against the named Defendants, their respective divisions, subsidiaries and affiliates, alleges the following:

INTRODUCTION

1. The claims asserted here are for fraudulent underpayments of billions of dollars owed as federal royalties on natural gas and natural gas liquids. They involve coordinated and common fraudulent "skimming" devices and schemes and conspiracies by Exxon Corporation and some of the other largest energy companies in the world (including companies owned or controlled by the Governments of Italy, France, Belgium, Holland and Great Britain), to defraud and cheat (1) the United States Treasury and thus all American taxpayers, (2) the Land and Water Conservation Fund, (3) the National Historic Preservation Fund, (4) the U.S. Reclamation Fund, (5) the States and educational funds of California, Texas, Alaska, Arkansas, Louisiana, Alabama, Oklahoma, Colorado, Arizona, New Mexico, Utah, Florida, Kansas, Michigan, Montana, North Dakota, South Dakota, Nebraska, Nevada and Wyoming, (6) more than 30 different American Indian Nations and Tribes,

(7) thousands of individual Indian allottees, and (8) various counties in the foregoing states in which National Wildlife Refuges and National Grasslands are located.

2. Defendants are lessees or interest owners under oil and gas leases from the U.S. Government and Indian Nations or Tribes covering many million acres of federal and Indian lands located in, and off the coasts of, the States named above.

3. All of these leases require Defendants to pay a fraction (usually only 1/8 or 1/6) of the production of natural gas ("gas") and natural gas liquids ("NGL") as a royalty to the U.S., for the benefit of those named above.

4. These leases, and governing laws and regulations, require Defendants to calculate these royalties both at (1) "not less than" the "market value" of the gas and NGL produced, and (2) "not less than" the Defendants' "gross proceeds" from such gas/NGL production. "Gross" legally means "the entire amount, without any deductions."

5. Over a period of more than 20 years, Defendants have systematically employed "skimming" devices to defraud and cheat the U.S. Government and all those named above, by calculating and paying royalties due on gas and NGL at much less than "market value," and at much less than Defendants' "gross proceeds" from such lease production.

6. These "skimming" devices include the following:

A. Defendants sell gas and NGL production to affiliated (often wholly-owned) "marketing" entities at artificially low prices, and pay royalties on the basis of these low prices. The affiliates then re-sell the gas and NGL at higher market prices (often at city-gate prices) on which no royalties are paid. This common industry practice is in flagrant violation of established case law and

the governing regulations. Those expressly require that royalties be calculated and paid on the basis of the higher re-sale prices of such gas/NGL by the marketing affiliates.

B. Gas which is actually processed for the removal of NGL (butane, propane, gasoline, etc.) is falsely reported as "unprocessed" gas on which no NGL royalties are paid. This fraudulent industry practice has become so wide-spread that Defendants now report only about 25% of the gas produced from the federal Outer Continental Shelf ("OCS") as "processed" gas, when in actual fact 100% of such OCS gas is "processed" for the removal and sale of NGL.

C. On the small portions of gas reported as "processed" for removal of NGL, unlawful deductions for processing costs, including non-deductible "marketing" fees, are wrongfully deducted from royalty payments.

D. Unlawful deductions are taken from "gross" royalty payments for transportation, processing and other non-deductible costs.

E. Defendants fraudulently allocate a part of the gross proceeds of gas sales to "supply reservation charges" and other charges on which no royalties are paid.

F. Gas produced during summer months when prices are low is placed into underground storage and sold during the winter months when prices are often more than 100% higher; but royalties are fraudulently underpaid only on the lower summer prices when the gas was stored, not on the much higher winter prices at which the gas was actually sold.

Other fraudulent "skimming" devices are employed, as detailed below.

JURISDICTION AND VENUE

7. This action is brought under the Federal False Claims Act, 31 U.S.C. § 3729 *et seq.*, (the "Act") to recover treble damages, civil penalties, costs of suit, including reasonable attorneys' fees, and to obtain ancillary relief. Relator is authorized to bring these claims on behalf of the United States pursuant to 31 U.S.C. § 3730(b). This Court has jurisdiction over this action under 31 U.S.C. § 3732(a) and 28 U.S.C. §§ 1331 and 1345 because this civil action arises under the laws of the United States.

8. Venue is proper in the Eastern District of Texas under 31 U.S.C. § 3732(a) because one or more of the defendants can be found, resides, or transacts business, in the Eastern District of Texas and because one or more of the acts proscribed by 31 U.S.C. § 3729 occurred in such district.

RELATOR

9. A. Relator is an individual domiciled within the Eastern District of Texas with his residence and place of business in Tyler, Smith County, Texas. Relator has been engaged in the oil and gas/NGL business for more than 50 years. He is the only independent oil and gas operator ever to be elected by the major energy company Defendants to be Chairman of the Washington, D.C.-based Natural Gas Supply Association ("NGSA"). The NGSA was formerly the gas/NGL arm of the American Petroleum Institute (the "API"), the principal industry organization of the major Defendants; the NGSA is now the separate and main industry organization for the major gas/NGL producer Defendants.

B. Relator is a former President and Board Chairman of the Texas Independent Producers and Royalty Owners Association ("TIPRO"), and a former member of the Executive Committee of the Independent Producers Association of America ("IPAA"). Relator is the founder

and first Board Chairman of the Petroleum Industry Security Council, organized to prevent oil field theft and fraud, and now headquartered in Houston.

C. For more than 30 years Relator has owned producing oil and gas royalty interests in the States of Texas, New Mexico, Louisiana, Colorado, Wyoming, Montana and North Dakota, as to which most of the major Defendants herein have underpaid him for his gas/NGL production by one or more of the fraudulent devices described herein. Relator is an original source of the information hereinafter set forth, and he institutes and prosecutes this action for violations of 31 U.S.C. § 3729 for himself and for the United States of America, pursuant to the provisions of 31 U.S.C. § 3730(b)(1).

10. Pursuant to Section 3730(e)(4)(B) of the Act, Relator has provided in writing to the Attorney General of the United States, prior to the filing of his complaint, all information on which the allegations herein are based. This statement of information, disclosing substantially all material evidence and information possessed by Relator relating to the complaint, was also served on the Government with the original complaint as required by Section 3730(b)(2) of the Act. This disclosure statement supports the existence of false claims by the Defendants.

DEFENDANTS

11. **AGIP Petroleum Company Incorporated** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation system, 350 North St. Paul, Dallas, Texas 75201.

12. **Amerada Hess Corporation** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, 350 North St. Paul, Dallas, Texas 75201.

13. **Amoco Production Company** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, 811 Dallas Avenue, Houston, Texas 77002.

14. **Anadarko Petroleum Corporation** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, 811 Dallas Avenue, Houston, Texas 77002.

15. **Anadarko Production Company** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, 811 Dallas Avenue, Houston, Texas 77002.

16. **ANR Production Company** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, 811 Dallas Avenue, Houston, Texas 77002.

17. **The Anschutz Corporation** is a Kansas corporation duly qualified to do business in Texas that may be served through its registered agent CT Corporation System, 350 North St. Paul Street, Dallas, Texas 75201.

18. **Apache Corporation** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, 811 Dallas Avenue, Houston, Texas 77002.

19. **Ashland Oil, Inc.** is a Kentucky corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation system, 350 North St. Paul, Dallas, Texas 75201.

20. **Atlantic Richfield Company** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, 350 North St. Paul, Dallas, Texas 75201.

21. **B.T. Operating Company** is a domestic corporation that may be served through its registered agent, R. Hobart Evans, III, 2425 Fountainview, Suite 100, Houston, Texas 77057.

22. **Basin Exploration, Inc.** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, 350 North St. Paul Street, Dallas, Texas 75201.

23. **Bass Enterprises Production Company** is a Texas corporation duly qualified to do business in Texas that may be served through its registered agent, W. Robert Cotham, 201 Main Street, Suite 1600, Fort Worth, Texas 76102.

24. **BP Exploration and Oil, Inc.** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, 811 Dallas Avenue, Houston, Texas 77002.

25. **BP Exploration (Alaska) Inc.** formerly known as **Sohio Alaska Petroleum Company** is a Delaware corporation that may be served through the Secretary of State. The Secretary of State may serve this defendant via Certified Mail or Registered Mail at 900 E. Benson Blvd., Anchorage, Alaska 99508.

26. **Bridge Oil Production Company** is a Delaware corporation doing business in Texas that may be served through its registered agent, George G. Fenton, 12404 Park Central Drive, Suite 400, Dallas, Texas 75251.

27. **Cabot Petroleum Corporation** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, 350 North St. Paul Street, Dallas, Texas 75201.

28. **Canadianoxy Offshore Production Company** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, Prentice-Hall Corporation System, 400 North St. Paul Street, Dallas, Texas 75201.

29. **Chevron U.S.A., Inc.** is a Pennsylvania corporation duly qualified to do business in Texas that may be served through its registered agent, Prentice-Hall Corporation System 400 North St. Paul Street, Dallas, Texas 75201.

30. **CNG Producing Company** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, Prentice-Hall Corporation System, 400 North St. Paul Street, Dallas, Texas 75201.

31. **Coastal Oil and Gas Corporation** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, 811 Dallas Avenue, Houston, Texas 77002.

32. **Coastal Oil and Gas U.S.A., L.P.** is a foreign limited partnership doing business in Texas that may be served through its registered agent, CT Corporation System, 811 Dallas Avenue, Houston, Texas 77002.

33. **Conoco, Inc.** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, 811 Dallas Avenue, Houston, Texas 77002.

34. **DEK Energy Company**, formerly known as **DEKALB Energy Company**, is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, 811 Dallas Avenue, Houston, Texas 77002.

35. **Delmar Operating, Inc.** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, 811 Dallas Avenue, Houston, Texas 77002.

36. **Elf Exploration, Inc.** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, 811 Dallas Avenue, Houston, Texas 77002.

37. **Energy Development Corporation** is a New Jersey corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, 811 Dallas Avenue, Houston, Texas 77002.

38. **Enserch Corporation** is a Texas corporation duly qualified to do business in Texas that may be served through its registered agent, Michael G. Fortado, Enserch Center, 300 South St. Paul, Dallas, Texas 75201.

39. **Enserch Exploration, Inc.** is a Texas corporation duly qualified to do business in Texas that may be served through its registered agent, Michael G. Fortado, Enserch Center, 300 South St. Paul, Dallas, Texas 75201.

40. **Enserch Offshore, Inc.** is a Texas corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation system, 350 North St. Paul Street, Dallas, Texas 75201.

41. **Equitable Resources Energy Company** is a West Virginia corporation duly qualified to do business in Texas that may be served through its registered agent at 2900 Grant Building, 330 Grant Street, Pittsburgh, Pennsylvania 15219.

42. **Exxon Corporation** is a New Jersey corporation duly qualified to do business in Texas that may be served through its registered agent, John F. Tully, 800 Bell Street, Houston, Texas 77002.

43. **Fina Exploration, Inc.** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, 350 North St. Paul Street, Dallas, Texas 75201.

44. **Fina Oil & Chemical Company** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, 350 North St. Paul Street, Dallas, Texas 75201.

45. **Forcenergy, Inc. f/k/a Forcenergy Gas Exploration, Inc.** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, The Prentice-Hall Corporation system, 400 North St. Paul, Dallas, Texas 75201.

46. **Forest Oil Company** is a New York corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, 350 North St. Paul Street, Dallas, Texas 75201.

47. **Freeport-McMoran, Inc.** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, 350 North St. Paul Street, Dallas, Texas 75201.

48. **Freeport-McMoran Oil & Gas Company** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, 811 Dallas Avenue, Houston, Texas 77002.

49. **Hall-Houston Oil Company** is a domestic profit corporation that may be served through its registered agent, Gary L. Hall, 700 Louisiana, Suite 2100, Houston, Texas 77002.

50. **Hamilton Brothers Corporation** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, 811 Dallas Avenue, Houston, Texas 77002.

51. **Hamilton Brothers Exploration Company** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, 811 Dallas Avenue, Houston, Texas 77002.

52. **Hamilton Brothers Oil Company** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, 350 North St. Paul Street, Dallas, Texas 75201.

53. **Helmerich & Payne, Inc.** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, Republic National Bank Building, Dallas, Texas 75201.

54. **Home Petroleum Corporation** is a Georgia corporation doing business in Texas that may be served through the Secretary of State. The Secretary of State may serve this defendant via Certified Mail or Registered Mail at P.O. Box 130, Calgary, Alberta, Canada.

55. **Houston Oil & Minerals Corporation** is a Nevada corporation duly qualified to do business in Texas that may be served through its registered agent Prentice-Hall Corporation System, 400 North St. Paul Street, Dallas, Texas 75201.

56. **Howell Petroleum Corporation** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, Robert T. Moffett, 1111 Fannin, Suite 1500, Houston, Texas 77002.

57. **Hunt Oil Company** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, John R. Scott, 1445 Ross Avenue, Suite 1400, Dallas, Texas 75202.

58. **Hunt Petroleum Corporation** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, James L. Parker, 3400 Thanksgiving Tower, Dallas, Texas 75201.

59. **Kerr-McGee Corporation** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, 350 North St. Paul Street, Dallas, Texas 75201.

60. **Kirby Exploration Company of Texas** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, 350 North St. Paul Street, Dallas, Texas 75201.

61. **Koch Exploration Company** is a Kansas corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, 350 North St. Paul Street, Dallas, Texas 75201.

62. **Koch Industries, Inc.** is a Kansas corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, 350 North St. Paul Street, Dallas, Texas 75201.

63. **Louis Dreyfus Reserves Corp.** is a Delaware corporation that may be served through its registered agent, CT Corporation System, 350 North St. Paul Street, Dallas, Texas 75201.

64. **The Louisiana Land & Exploration Company** is a Maryland corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, 811 Dallas Avenue, Houston, Texas 77002.

65. **LLECO Holdings, Inc.** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, 350 North St. Paul Street, Dallas, Texas 75201.

66. **LLOXY Holdings, Inc.** is a Maryland corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, 811 Dallas Avenue, Houston, Texas 77002.

67. **Marathon Oil Company** is an Ohio corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, 811 Dallas Avenue, Houston, Texas 77002.

68. **McMoran Oil & Gas Company** is a Delaware corporation doing business in Texas that may be served through the Secretary of State. The Secretary of State may serve this defendant via Certified Mail or Registered Mail at P.O. Box 6800, Metairie, Louisiana 70009.

69. **Meridian Oil, Inc.** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, 350 North St. Paul Street, Dallas, Texas 75201.

70. **Meridian Oil Production, Inc.** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, 350 North St. Paul Street, Dallas, Texas 75201.

71. **Mesa Operating Limited Partnership** is a foreign limited partnership that may be served through its registered agent, CT Corporation System, 350 North St. Paul Street, Dallas, Texas 75201.

72. **MidCon Exploration Company** is a Delaware corporation doing business in Texas that may be served through the Secretary of State. The Secretary of State may serve this defendant via Certified Mail or Registered Mail at 110 West 7th Street, P.O. Box 300, Tulsa, Oklahoma 74102.

73. **MidCon Offshore, Inc.** is a Texas Corporation duly qualified to do business in Texas that may be served through its registered agent, John N. Ehrman, 12450 Greenspoint Drive, Suite 1100, Houston, Texas 77060.

74. **Mitchell Energy Corporation** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, Thomas P. Battle, 2002 Timberloch Place, the Woodlands, Texas 77380.

75. **Mobil Oil Corporation** is a New York corporation duly qualified to do business in Texas that may be served through its registered agent, Prentice-Hall Corporation System, 400 North St. Paul Street, Dallas, Texas 75201.

76. **Mobil Oil Exploration and Production** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, Prentice-Hall Corporation System, 400 North St. Paul Street, Dallas, Texas 75201.

77. **Mobil Exploration and Producing North America, Inc.** is a Nevada corporation duly qualified to do business in Texas that may be served through its registered agent, Prentice-Hall Corporation System, 400 North St. Paul Street, Dallas, Texas 75201.

78. **Mobil Producing Texas & New Mexico, Inc.** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, Prentice-Hall Corporation System, 400 North St. Paul Street, Dallas, Texas 75201.

79. **Mobil Oil Exploration & Producing Southeast, Inc.** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, Prentice-Hall Corporation System, 400 North St. Paul Street, Dallas, Texas 75201.

80. **Mosbacher Energy Company** is a Texas corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, 811 Dallas Avenue, Houston, Texas 77002.

81. **Mosbacher Offshore, Inc.** is a Texas corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, 811 Dallas Avenue, Houston, Texas 77002.

82. **Murphy Exploration & Production Company** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, 350 North St. Paul Street, Dallas, Texas 75201.

83. **Newfield Exploration Company** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, The Prentice-Hall Corporation System, 400 North St. Paul Street, Dallas, Texas 75201.

84. **Norcen Explorer, Inc.** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, 350 North St. Paul Street, Dallas, Texas 75201.

85. **Nuevo Energy Company** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, 811 Dallas Avenue, Houston, Texas 77002.

86. **Oxy U.S.A., Inc.** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, The Prentice-Hall Corporation System, 400 North St. Paul Street, Dallas, Texas 77201.

87. **Oryx Energy Company** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, 350 North St. Paul Street, Dallas, Texas 75201.

88. **Pacific Offshore Company** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, Walter M. Edwards, 453 Texas National Bank Building, Houston, Texas 77002.

89. **Parker & Parsley Petroleum Company** is a Nevada corporation doing business in Texas that may be served through the Secretary of State. The Secretary of State may serve this defendant via Certified Mail or Registered Mail at 600 West Illinois, Suite 103, Midland, Texas 79701.

90. **Pennzoil Company** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, 811 Dallas Avenue, Houston, Texas 77002.

91. **Pennzoil Exploration and Production Company** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, 350 North St. Paul Street, Dallas, Texas 75201.

92. **Pennzoil Petroleum Company** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, 350 North St. Paul Street, Dallas, Texas 75201.

93. **Petrofina Delaware, Inc.** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, 350 North St. Paul Street, Dallas, Texas 75201.

94. **Petrofina Exploration, Inc.** is a Texas corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, 1601 Elm Street, Dallas, Texas 75201.

95. **Petro-Hunt Corporation** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, Walter P. Roach, 1601 Elm Street, Dallas, Texas 75201.

96. **Phillips Petroleum Company** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, United States Corporation Company, 400 North St. Paul Street, Dallas, Texas 75201.

97. **Placid Oil Company** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, Prentice-Hall Corporation System, 400 North St. Paul Street, Dallas, Texas 75201.

98. **Pogo Gulf Coast Limited** is a Texas corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, 811 Dallas Avenue, Houston, Texas 77002.

99. **Pogo Producing Company** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, 811 Dallas Avenue, Houston, Texas 77002.

100. **Questar Oil and Gas Company** is a Texas corporation duly qualified to do business in Texas that may be served through its registered agent, John D. White, 910 Travis, Suite 1700, Houston, Texas 77002.

101. **Quintana Energy Corporation** is a Texas corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, 811 Dallas Avenue, Houston, Texas 77002.

102. **Quintana Offshore, Inc.** is a Texas corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, 811 Dallas Avenue, Houston, Texas 77002.

103. **Quintana Petroleum Corporation** is a Texas corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, 811 Dallas Avenue, Houston, Texas 77002.

104. **The Rosewood Corporation** is a Texas corporation duly qualified to do business in Texas that may be served through its registered agent, Tom S. Bunnell, 100 Crescent Court, Suite 1700, Dallas, Texas 75201.

105. **Rosewood Resources, Inc.** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, Gary Taraba, 100 Crescent Court, Suite 500, Dallas, Texas 75201.

106. **Rowan Companies, Inc.** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, Mark H. Hay, 5450 Transco Tower, 2800 Post Oak Blvd., Houston, Texas 77056-6111.

107. **Rowan Petroleum, Inc.** is a Texas corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, 811 Dallas Avenue, Houston, Texas 75201.

108. **Samedan Oil Corporation** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, 350 North St. Paul Street, Dallas, Texas 75201.

109. **Santa Fe Energy Resources, Inc.** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, D.L. Hicks, 1616 South Voss Road, Houston, Texas 77057.

110. **Shell Consolidated Energy Resources, Inc.** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, 811 Dallas Avenue, Suite 1500, Houston, Texas 77002.

111. **Shell Frontier Oil & Gas, Inc.** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, 811 Dallas Avenue, Houston, Texas 77002.

112. **Shell Gas Pipeline Company** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, 811 Dallas Avenue, Houston, Texas 77002.

113. **Shell Land & Energy Company** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, 811 Dallas Avenue, Suite 1500, Houston, Texas 77002.

114. **Shell Offshore, Inc.** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, 811 Dallas Avenue, Houston, Texas 77002.

115. **Shell Oil Company** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, 811 Dallas Avenue, Houston, Texas 77002.

116. **Shell Pipe Line Corporation** is a Maryland corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, 811 Dallas Avenue, Houston, Texas 77002.

117. **Shell Western E & P Inc.** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, Prentice-Hall Corporation System, 400 North St. Paul Street, Dallas, Texas 75201.

118. **Snyder Oil Corporation** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, Rodney L. Waller, 777 Main Street, Suite 2500, Ft. Worth, Texas 76102.

119. **Snyder Oil Partners, L.P.** is a foreign limited partnership doing business in Texas that may be served through their registered agent, Snyder Oil Company, 2500 Interfirst Tower, Fort Worth, Texas 76102.

120. **Snyder Operating Partnership, L.P.** is a foreign limited partnership doing business in Texas that may be served through their registered agent, Snyder Oil Co., 2500 Interfirst Tower, Fort Worth, Texas 76102.

121. **Southwestern Energy Production Company** is an Arkansas corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, 350 North St. Paul Street, Dallas, Texas 75201.

122. **Sun Operating Limited Partnership** is a foreign limited partnership that may be served through its registered agent, CT Corporation System, 350 North St. Paul Street, Dallas, Texas 75201.

123. **Taylor Energy Company** is a Louisiana corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, 811 Dallas Avenue, Houston, Texas 77002.

124. **Tenneco Gas Production Corporation** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, 811 Dallas Avenue, Houston, Texas 77002.

125. **Tenneco Oil Company** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent CT Corporation System, 811 Dallas Avenue, Houston, Texas 77002.

126. **Tesoro Petroleum Corporation** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent CT Corporation System, 350 North St. Paul Street, Dallas, Texas 75201.

127. **Texaco Exploration and Production, Inc.** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, Prentice-Hall Corporation System, 400 North St. Paul Street, Dallas, Texas 75201.

128. **Texaco, Inc.** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, Prentice-Hall Corporation System, 400 North St. Paul Street, Dallas, Texas 75201.

129. **Torch Energy Associates Ltd.** is a Texas corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, 811 Dallas Avenue, Houston, Texas 77002.

130. **Torch Operating Company** is a Texas corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, 350 North St. Paul Street, Dallas, Texas 75201.

131. **Transco Exploration Company** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, 350 North St. Paul Street, Dallas, Texas 75201.

132. **Union Pacific Resources Company** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, 350 North St. Paul Street, Dallas, Texas 75201.

133. **UNOCAL Corporation** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, 350 North St. Paul Street, Dallas, Texas 75201.

134. **Union Oil Company of California** is a California corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, 811 Dallas, Houston, Texas 77002.

135. **Union Texas Petroleum Corporation** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, 811 Dallas Avenue, Houston, Texas 77002.

136. **Valero Energy Corporation** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, 811 Dallas Avenue, Houston, Texas 77002.

137. **Valero Producing Company** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, 811 Dallas Avenue, Houston, Texas 77002.

138. **Vastar Resources, Inc.** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent, CT Corporation System, 350 North St. Paul Street, Dallas, Texas 75201.

139. **Walter Oil & Gas Corporation** is a domestic profit corporation that may be served through its registered agent, CT Corporation System, 811 Dallas Avenue, Houston, Texas 77002.

140. **Zapata Corporation** is a Delaware corporation duly qualified to do business in Texas that may be served through its registered agent CT Corporation System, 811 Dallas Avenue, Houston, Texas 77002.

141. **Zapata Exploration Company** is a Delaware corporation doing business in Texas that may be served through its registered agent, CT Corporation System, 811 Dallas Avenue, Houston, Texas 77002.

FACTS

142. Defendants are lessees or interest owners under oil and gas leases of Federal onshore, Indian and/or Outer Continental Shelf ("OCS") (collectively "federal") lands belonging to or administered by the United States Government.

143. As such, Defendants are legally obligated under the provisions of their leases, and the applicable federal statutes and regulations, to account for and pay to the United States Government the royalties on gas and NGL produced from federal lands as provided in such leases.

144. Most of the gas and NGL produced from federal lands is produced from OCS leases. Most OCS leases provide that "the value of production for purposes of computing royalty on production from this lease shall never be less than the fair market value of the production." Most OCS leases also provide that "the value of production for purposes of computing royalty shall not be deemed to be less than the gross proceeds accruing to the Lessee from the sale thereof." Subject to these two separate basic limitations, the OCS leases provide that the value of production shall be "as determined by the Lessor...."

145. The collection of government royalties on federal (including Indian) lands is administered by the Management Minerals Service ("MMS") of the United States Department of the Interior ("DOI").

146. MMS requires each lessee to file a monthly report (MMS-2014) of gas and NGL sales and royalty remittances for the preceding production month. This report form requires the lessee to state the sales values and values at which the gas and NGL royalties have been calculated for royalty payment purposes.

147. Form MMS-2014 bears the following statement:

"WARNING: This is to inform you that failure to report accurately and timely in accordance with the statutes, regulations or terms of the lease, permit, or contract may result in late payment charges, civil penalties, or liquidated damages being assessed without further notification. Intentional false or inaccurate reporting is subject to criminal prosecution in accordance with applicable Federal law(s)."

148. In addition, Form MMS-2014 has a signature line which bears the following statement:

"I have read and examined the statements in this report and agree that they are accurate and complete."

149. 30 C.F.R. Section 206.152 provides the royalty valuation standard for unprocessed gas produced and sold from federal lands. Subsection (b)(1)(i) of such section provides.

The value of gas which is sold pursuant to an arm's-length contract shall be the gross proceeds accruing to the lessee, except as provided in paragraphs (b)(1)(ii) and (iii) of this section." (emphasis added).

Paragraph (b)(1)(ii) provides that if the contract does not reflect the total consideration "actually transferred either directly or indirectly from the buyer to the seller for the gas," then "(v)alue may not be less than the gross proceeds accruing to the lessee, including the additional consideration." (emphasis added).

150. 30 C.F.R. Section 206.153 provides the royalty valuation standard for processed gas produced and sold from federal lands. Subsection (h) of such section provides:

"(h) Notwithstanding any other provision of this section, under no circumstances shall the value of production for royalty purposes be less than the gross proceeds accruing to the lessee for residue gas and/or any gas plant products...." (emphasis added).

151. At least since 1986, the value of gas and NGL production on which the Defendants have paid royalties to DOI-MMS has been less than the true total consideration and "gross proceeds" received by Defendants after allowable deductions.

152. Defendants have had actual knowledge of the gross proceeds actually received by them for their lease production of gas and NGL, and that these gross proceeds have been greater than the prices on the basis of which they have made their royalty payments to the United States Government.

153. Consequently, as to each lease covering federal lands in which any Defendant has had an interest during the past twelve years or more, each MMS-2014 monthly report form filed by such Defendant has knowingly and falsely stated the gross proceeds accruing to such Defendant for its lease production of gas and NGL, and the amounts owed by said Defendant to the United States Government, in order to conceal, avoid or decrease its obligation to pay or transmit money to the United States Government.

154. Item 16 of Form MMS-2014 is entitled "Sales Value." Each such line item 16 on each line of each monthly Form MMS-2014 filed by each Defendant with the federal government during the last twelve (12) years for sales of processed gas which represents less than the gross proceeds accruing to the lessee and its affiliates for residue gas and/or NGL, less any proper allowances, has

been a knowingly false statement, and a separate violation of the False Claims Act for which a civil penalty lies; and Relator seeks to recover from each such Defendant herein the maximum civil penalty for each such separate violation.

155. Item 18 of Form MMS-2014 is entitled "Royalty Value." Each such line item 18 on each line of each monthly MMS-2014 filed by each Defendant with the federal government during the last twelve (12) years for sales of processed gas which represents less than the gross proceeds accruing to the lessee and its affiliates for residue gas and/or NGL, less any proper allowances, has been a knowingly false statement, and a separate violation of the False Claims Act for which a civil penalty lies; and the Relator seeks to recover from each such Defendant herein the maximum civil penalty for each such separate violation.

156. Similarly, each Item 16, "Sales Value," and each Item 18, "Royalty Value," on each line of each monthly Form MMS-2014 filed by each Defendant with the federal government during the last twelve (12) years for sales of unprocessed gas which represents less than the gross proceeds accruing to the lessee and its affiliates on the sale of such unprocessed gas, less any proper allowances, has been a knowingly false statement, and a separate violation of the False Claims Act for which a civil penalty lies; and Relator seeks to recover from each such Defendant herein the maximum civil penalty for each such separate violation.

DEFENDANTS' CONTROL OF INFORMATION

157. Defendants' claim that all their Form MMS-2014 monthly report forms filed with DOI-MMS are confidential, proprietary, and protected from public disclosure because of the proprietary pricing information contained therein. DOI-MMS, by regulations, confidentiality agreements and

practice, has accepted this claim. It will not produce these reports even in response to a "FOIA" demand under the Freedom of Information Act.

158. These records are necessary to prove the actual amount of royalty payments on gas/NGL by Defendants. They are not available to Relator. The only copies are in the exclusive possession of Defendants who made and filed them.

159. Defendants also claim that their contracts whereby they sold the gas/NGL produced from federal lands are confidential and proprietary, and protected from public disclosure because of the pricing information contained therein. Defendants have exacted confidentiality and non-disclosure agreements from purchasers of such gas/NGL; and even when Defendants or their purchasers have been required to file such sales contracts with governmental agencies (such as the New York Public Service Commission), the pricing provisions have been redacted prior to filing.

160. Relator's claim is that actual royalty payments have been less than royalty gross proceeds. The information required to prove both components of this claim, *i.e.*, (1) gross proceeds amounts v. (2) actual royalty values reported and paid, have been and are in the sole and exclusive possession of Defendants.

161. Where the necessary information is in the possession of defendants, the law relaxes the requirement of Fed. R. Civ. P. 9(b) that fraud be pled with particularity.

NUMEROSITY AND TIME PERIOD OF FRAUDULENT TRANSACTIONS

162. There currently are more than 25,000 separate producing federal (including Indian) oil and gas leases covering in all more than twenty million acres of federal land.

163. As shown above, there may be two or more false statements on each monthly Form MMS-2014 on each of such 25,000 leases, for each month during the past 12 years.

164. Thus, there could be more than 7,200,000 false statements and fraudulent transactions covered hereby.

165. It is entirely impractical to plead particularly each of such millions of false statements and fraudulent transactions.

166. When the fraudulent transactions are numerous and extend over a long period of time, the law also relaxes the particularity requirements of Fed. R. Civ. P 9(b).

PARTICULAR FRAUDULENT SCHEMES AND DEVICES

167. Defendants have devised at least nineteen (19) fraudulent schemes and devices to mislead the Government and thereby underpay their gas and NGL royalty obligations. These have included:

- (1) selling gas to an "affiliate" which resells at higher prices, but paying royalty only on the lower-priced first sale to the affiliate, in direct violation of DOI-MMS regulations requiring payment of royalties based on the higher re-sale price by the affiliate;
- (2) selling gas which is actually processed for removal of NGL by the producer or an affiliate as "unprocessed" gas on which no NGL royalties are paid;
- (3) entering into NGL processing agreements with affiliated processors whereby the producer retains only a percentage of the NGL or its proceeds and the affiliated processor acquires the balance, and paying royalties only on the producer-retained percentage;
- (4) undermeasuring, or allowing others to undermeasure, the actual quantities of NGL produced or removed from federal lands, and reporting and paying royalties only on the undermeasured quantities;

- (5) undermeasuring, or allowing others to undermeasure, the quantities of gas produced from federal lands, and paying gas royalties only on the undermeasured quantities;
- (6) allocating a portion of the gross proceeds of the sale of gas as a "supply reservation charge" or other charges, and not paying royalties on such portion of the gross proceeds;
- (7) placing gas in storage, or "selling" gas to an affiliate which places it in storage, during summer months when gas prices are low, and paying royalties on the basis of the low summer prices, instead of at the higher winter prices at which the gas is actually sold by the producer or affiliate after it is removed from storage;
- (8) taking legally unauthorized deductions for "marketing" fees, costs or expenses on gas and/or NGL;
- (9) taking deductions from royalty payments for costs of processing, handling, treating, dehydrating, compressing, storing, parking, banking, wheeling and/or transporting gas and/or NGL which are unauthorized by law, lease terms and/or regulations;
- (10) "commingling" federal gas to obtain "aggregation" premiums without paying royalties on the premiums;
- (11) utilizing financing and tax devices such as "volumetric production payments" to mask the true gross proceeds of gas sales by producers and their affiliates, and thus underpaying gas and NGL royalties actually owed;
- (12) using gas "swaps" or exchanges to underpay gas royalties;
- (13) using the device of fictional pipeline "backhauling" to underpay gas royalties;
- (14) failing to pay royalties as required by law on amounts paid as "buy-outs" and "buy-downs" of gas sales contracts;

- (15) taking unlawful deductions for transportation and processing costs;
- (16) taking deductions for non-deductible gathering costs improperly treated as allegedly deductible transportation costs;
- (17) failing to pay royalties on refunds or downward adjustments by pipeline carriers;
- (18) Failing to pay royalties on upward price adjustments and additional payments made by purchasers of gas and NGL after the initial payments in which royalties were paid; and
- (19) paying royalties on the lower, instead of the higher, of (1) gross proceeds or (2) market value, as required by OCS and Indian leases.

The fraudulent devices and schemes listed above are described with more particularity below:

168. Gas Sales to Affiliates.

A. Defendants sell both "processed" gas and "unprocessed" gas produced from federal leases to "affiliates" at low prices. The affiliates resell the gas at higher (often city-gate) prices. Royalty is paid to the U.S. at the lower priced sale to the affiliate, instead of at a higher resale price by the affiliate.

B. This is in flagrant violation of lease terms, applicable regulations and established case law. 30 C.F.R. Sec. 206.152(b)(1)(i) ("unprocessed" gas) and Sec. 206.153(b)(1)(i) ("processed" gas) both clearly and expressly provide that "gas which is sold or otherwise transferred to the lessee's marketing affiliate and then sold by the marketing affiliate pursuant to an arm's-length contract shall be valued in accordance with this paragraph based on the sale by the marketing affiliate."

C. Lease terms and regulations also require that royalty be paid based on "not less than the gross proceeds accruing to the lessee." The regulations also provide that royalty must be

paid on the "the total consideration actually transferred either directly or indirectly from the buyer to the seller for the gas."

D. Settled case law and DOI regulations both impose on Defendants the "duty to the lessor to market the production for the mutual benefit of lessee and lessor." 30 C.R.R. Sec. 206.152(b)(1)(iii) and Sec. 206.153(b)(1)(iii).

E. Paying gas royalties on the basis of sales to affiliates violates all these valuation regulations, as well as controlling lease provisions and case law.

F. Some defendants, including Mobil, Texaco, Phillips and most non-integrated OCS gas producers, have sold their federal gas through 100% wholly owned affiliates or divisions. Other Defendants, including Shell and Chevron, at times have sold their gas through affiliates which are partly owned, and at other times through affiliates which are wholly owned.

169. Evading NGL Royalties by Falsely Reporting Gas As "Unprocessed."

A. Defendants have evaded payment of NGL royalties owed to the U.S. by falsely reporting as "unprocessed" gas which is in fact processed for removal of NGL, water and other impurities required to render it marketable, "pipeline" quality gas (*i.e.*, pure methane).

B. This fraudulent practice is so widespread that federal gas, which in 1994 constituted 36.2% of total reported U.S. gas production, reportedly produced only 9.5% of total U.S. NGL production. This is a physical (and fiscal) absurdity, and fraud on a grand scale.

C. All OCS gas, and most other federal gas, is in fact processed for removal of NGL, water and other impurities. Such processing is necessary for the gas to become marketable "pipeline" quality gas, because the main transmission pipelines and gas purchasers require removal of such NGL, waster and other impurities.

D. OCS gas production is processed in large NGL-processing "straddle" plants located onshore in Louisiana near the coast line. These NGL plants "straddle" major pipeline systems by which OCS gas is marketed, and process 100% of the gas throughput in such pipelines.

E. These plants are owned by the Defendant OCS gas producers or their affiliation in undivided percentage interests which often reflect their approximate percentages of ownership of OCS gas processed in the plants.

F. Plant ownership percentages in some of the large straddle plants (*e.g.*, Calumet in St Mary's Parish operated by Shell-Coral, Yscloskey in St. Bernard's Parish operated by Chevron-NGC, and Grand Chenier in Cameron parish operated by ARCO-Vastar Resources) are adjusted periodically (usually annually) to reflect changes in percentage ownership of gas processed at the plants.

G. Defendants report gas which is processed as "unprocessed" gas and so pay royalties based on the BTU content of such gas, including the NGL contained therein, at the lower prices for gas instead of at the higher prices obtained for the NGL actually removed from such gas and sold as NGL.

H. Defendants fraudulently report gas as "unprocessed" which is in fact processed by wholly or partly owned "affiliates" and/or which is processed in plants in which the lessee or an affiliate owns interests.

I. These practices also are fraudulent evasions of Defendants' obligations under the DOI regulations providing that the value of production of processed gas "shall be the combined value of the residue gas and all gas plant products" (30 C.F.R. Sec. 206.153(a)(2)), and that "Notwithstanding any other provision of this section, under no circumstances shall the value of

production for royalty purposes be less than the gross proceeds accruing to the lessee for residue and/or any gas plant products. . . ." 30 C.F.R. Sec. 206.153(h).

J. These practices are also evasions of Defendants' obligations under the regulations and settled case law to market all gas and NGL production for the mutual benefit of lessor and lessee at no cost to lessor.

170. Evading NGL Royalties by Percentage Processing Agreements with Affiliated NGL Plants.

A. Defendants have evaded and underpaid NGL royalties owed to the U.S. by processing and other agreements with affiliated processing plants whereby the lessee-producer Defendants reserve or receive only a percentage of the NGL attributable to their gas/NGL ownership interests and the NGL processing plant acquires the balance of such NGL, purportedly as compensation for the processing. Defendants then pay royalty only on the producer-retained percentage of NGLs instead of the entire royalty percentage specified in the federal leases.

B. In many such instances, especially on OCS production, the lessee-producer Defendants or their affiliates are also co-owners of the NGL processing plants. As such they thereby acquire, on an allegedly royalty-free basis, the percentage of NGL production relinquished by the lessee-producer to the processing plant.

C. Where such is the case, these contracts are self-dealing and fraudulent devices to underpay NGL royalties, as are also all assignments of NGL processing rights by lessees to affiliates (a related royalty evasion device).

D. The self-serving, fraudulent and royalty-avoidance nature of these arrangements is made even more self-evident in the large "straddle" plants processing OCS gas/NGL

production in which the plant ownership and operating agreements themselves provide that plant ownership percentages among the co-owners are adjusted periodically to reflect variations in ownership of gas/NGL processed in the plants.

E. Defendants apparently have claimed that such processing agreements are "arm's-length" because they have been entered into nominally with the NGL plant operator, which often is another major gas/NGL producer that may not legally be an "affiliate" of a particular lessee-producer Defendant.

F. But such non-affiliated plant operator is, under the terms of the plant ownership and operating agreements, acting merely as agent for all the non-operating plant co-owners, including the lessee-producer Defendants or their affiliates. Such Defendants and their affiliates are in fact and in law simply contracting with themselves. Their contracts are not "arm's-length" and cannot serve as a lawful basis for computing and paying NGL royalties.

G. In all cases in which the lessee-producer Defendant or its affiliate is a co-owner of the NGL processing plant which has acquired, through processing or other agreements, all or a portion of the lessee-producer's ownership interest in the NGLs processed in the plant, payment of NGL royalties calculated only on the portion (if any) retained by the lessee-producer violates (1) the controlling "gross proceeds" and separate "market value" requirements of the federal lease royalty provisions, (2) the duties to market and render production marketable provided in both case law and DOI regulations, and (3) the provisions of the applicable DOI regulations requiring that contracts with affiliates be disregarded for purposes of royalty calculations.

H. In cases in which the lessee-producer Defendant or its affiliates is not a co-owner of the NGL processing plant which has acquired all or a portion of the lessee-producer's

ownership interest in the NGL processed in the plant, payment of NGL royalties calculated only on any portion thereof retained by the lessee-producer violates the "market value" requirements of controlling lease royalty provisions and of DOI regulations. In such cases, market value must be determined on the basis of the sales value to independent third parties of 100% of the NGLs removed at the plant, because that is the royalty market value for the other lessee-producer plant co-owners who do have ownership interests in the same plant, and whose similar processing agreements with affiliates must be disregarded.

I. Such percentage-sharing processing agreements must be disregarded for royalty calculation purposes for an additional reason.

J. All gas processing plants remove NGL, water and other impurities. The removal of NGL, as well as water and other impurities, is necessary to render that gas "dry," marketable, "pipeline" quality gas (*i.e.*, methane free of the impurities of NGL, water and other substances). Pipelines will not accept for carriage in their main lines, and end-users will not accept for purchase, gas containing NGL, water or other impurities.

K. All costs of processing gas for removal of NGLs, water and other impurities are costs of production, or costs of placing the production into a marketable condition and/or of marketing the gas production. None of such costs are legally deductible from royalty payments.

171. NGL Royalty Underpayments by Undermeasurements.

A. Income and operating statements on NGL plants processing federal gas, particularly OCS gas, usually or frequently report "plant overages," *i.e.*, excesses of NGL actually produced over measured NGL content of incoming gas processed (on the basis of which royalties

have been calculated and paid). This is the result of undermeasurement of NGL content of the gas processed in the plant, which in turn results in underpayment of royalties on NGL.

B. NGL content of federal gas is undermeasured by the following devices, among others:

1. Improperly calibrating or reporting of the size of the gas measurement orifice (*i.e.*, calculating volume of gas, and hence NGL contained therein, on the basis of a smaller orifice than is actually in place).
2. Placing the BTU measurement probe immediately downstream, instead of immediately upstream, of the gas measurement orifice, resulting in a misrepresentative undermeasurement of the true NGL content.
3. Inserting the temperature measurement probe immediately upstream of the BTU measurement probe, and immediately downstream of the measurement orifice, resulting in an undermeasurement of true NGL content.
4. Using water filters which filter out not only water but the heavier (and more valuable) NGL from gas samples taken for measurement of NGL content.
5. Installing by-passes around measurement equipment so that gas (and NGL) is produced and sold without being measured.
6. Failing to report gas and NGL produced and vented or flared during tests and during periods when pipelines are shut-in or mechanical problems prevent production into gathering lines.
7. Using incorrect pressure data in measurement formulas.
8. Failing to report properly NGL produced into oil and/or condensate lines.

9. Failing to report properly quantities of NGL extracted upstream and/or downstream of processing plants.

10. Failing to pay NGL royalties on retroactive upward adjustments of volume contained in supplemental, amended and corrective NGL plant statements.

172. Gas Royalty Underpayments by Undermeasurements.

A. Gas gathering lines and gas pipelines usually or frequently report sales and/or deliveries in excess of purchases and/or receipts. This is due to undermeasurement of gas at royalty settlement points, and results in underpayment of gas royalties.

B. Undermeasurements of gas on which royalty is due has been accomplished by the following devices, among others:

1. Using a larger gas measurement orifice than that on which volumes are calculated and reported.
2. Producing gas as through by-passes which avoid measurement devices.
3. Failing to report, and pay royalties on, gas used for compression and other purposes prior to delivery into trunk pipelines or at NGL plant tailgates.
4. Failing to report, and pay royalties on, gas produced and vented or flared.
5. Undermeasuring NGL and BTU content of gas sold on a "wetstream" basis, by virtue of the devices enumerated in the preceding paragraph and others, and thereby underpaying royalties due on gas production.
6. Using mechanical gas measurement equipment which underranges and/or overranges, and thus does not accurately report all gas throughput.

7. Failing to maintain in accurate condition and calibrate with sufficient frequency gas measurement equipment.

172. Gas Royalty Underpayments by "Supply Reservations Charges," etc.

A. Defendants have entered into gas sales or purchase contracts with local distribution companies, commercial and industrial users, and others, which allocate a portion of the gross proceeds of gas sold to a "commodity" charge, and the remainder of such gross proceeds to a "supply reservation charge" or to other charges. Defendants then have improperly and illegally paid royalties calculated only on the basis of the "commodity" charge portion of the gross proceeds.

B. This violates both the "gross proceeds" requirement of the royalty provisions in the federal leases, and the requirement of the regulations that royalty be calculated on "the total consideration actually transferred either directly or indirectly from the buyer to the seller of the gas." 30 C.F.R. Sec. 206.152(b)(1)(ii) and (b)(3) and Sec. 153.206(b)(1)(ii) and (b)(3).

173. "Selling Gas and NGLs into Storage." A. Gas prices historically have been much lower in the summer months when demand is lower, than in winter months when heating demand is higher. Defendants have adopted the practice of storing, in depleted natural underground reservoirs equipped especially for that purpose, all or a substantial portion of their summer federal gas production when gas prices have been lower.

B. Defendants have underpaid gas royalties by either "selling into storage" their summer gas production to affiliates, which later withdraw it from storage and re-sell it at higher winter prices, or by simply storing it themselves, withdrawing it later, and making a first sale of the gas at higher winter prices.

C. In either event Defendants have paid gas royalties based only on the lower summer values rather than the actual gross proceeds received by them or their affiliates upon the withdrawal and sale at winter prices.

D. In either event this practice violates the "gross proceeds" requirement of federal leases and regulations and the "duty to market for the mutual benefit of lessor and lessee" specified both by regulation and established case law. See Sections 206.152(b)(1)(i) and 206.153(1b)(1)(i).

E. To the extent this fraudulent practice is accomplished through affiliates, it violates the requirements of the regulations that royalties cannot be calculated on the prices of sales to affiliates, but rather must be calculated on the re-sale price by the affiliates to independent third parties.

F. The same practice is employed with respect to NGL. These are often stored during periods of lower demand and prices, and withdrawn from storage and sold during periods of higher demand and prices. When royalties are calculated on the basis of prices at time of storage rather than gross proceeds actually received when withdrawn from storage and sold, this practice violates the same lease provisions, regulations and case law.

174. Unlawful Deduction of Marketing Fees.

A. Operators of gas processing plants charge plant co-owners (including themselves) a marketing fee for selling NGL produced at the plants. This fee typically has been about 1 cent per gallon, or 42 cents per barrel.

B. Defendants have deducted these fees from royalty payments as part of their claimed deductions for processing costs.

C. This practice is clearly illegal. The regulations and case law consistently have made clear that the lessee has the duty to market, and that no marketing costs can be deducted from royalty payments. Even the 1987 regulations applicable to leases executed prior to existing regulations provide that "[n]o allowance shall be made for boosting residue gas or other expenses incidental to marketing." 30 C.F.R. Sec. 206.151(d) and Sec. 206.106(b) (7-1-87 Edition).

175. Unlawful Deductions for Processing and Other Costs.

A. Defendants have taken deductions from royalty payments for costs of processing, dehydrating, compressing, "boosting," storing, parking, banking, wheeling and/or transferring, both gas and NGL. All of such deductions are unlawful because all of these activities are either part of the costs of "production" or part of the costs of "marketing." Neither production costs nor marketing costs are legally deductible from royalty payments.

B. Such deductions are unlawful because of the "gross proceeds" requirements for royalty calculation both in the OCS and Indian leases themselves, and in the regulations. The term "gross" legally means "the entire amount, without deductions." It cannot be subverted to mean "net after deduction of processing and other charges."

C. To the extent that DOI-MMS regulations are claimed to authorize any deductions, they are invalid because inconsistent with the controlling, specific, OCS and Indian lease terms providing that royalty must be calculated on not less than "gross proceeds."

D. The regulations themselves provide that "[i]f the specific provisions of any . . . lease . . . are inconsistent with any regulation . . . the lease . . . shall govern to the extent of that inconsistency." 30 C.F.R. § 206.150(b). To the extent any regulations purport to authorize deductions for any of these costs, they are inconsistent with the specific and controlling provisions

of the leases requiring royalties to be calculated and paid on the basis of not less than "gross proceeds."

As alleged above, all costs of processing gas to remove NGL, water and other impurities are necessary to render the gas in marketable condition and "dry," pipeline quality gas which pipelines physically can accept for transmission, and which buyers physically can accept for boiler and burner-tip use. All of such "processing" costs are non-deductible from royalty payments. They are nondeductible "marketing" costs or costs required to place the gas "in marketable condition." The lessees duty to market gas at no cost to lessor precludes the deduction of such costs from royalty payments.

176. "Commingling" and Sales at "Aggregation" Premiums.

A. Gas market pricing has developed so that contracts covering large quantities of gas have commanded aggregation premiums, above spot market prices.

B. Large gas producers with known large gas reserves have commanded the aggregation premiums from major-end users and LDCs in gas contracts that are not "source-specific," *i.e.*, do not contractually commit the producer-seller to dedicate any particular leases, wells or fields to the performance of these contracts.

C. By use of these contracts, Defendants have attempted to assure that all their own production is sold, and royalties have been paid to the U.S., outside these premium contracts, so that Defendants have kept all of the premiums, and have shared none of them with the U.S. as royalty owner.

D. Defendants have attempted to accomplish this by buying, or having their affiliates buy, third-party production at lower, spot market, prices. This low-priced, spot market gas

is then sold under the premium contracts attributable to the Defendants' large OCS and other federal gas reserves and deliverability.

E. Defendants have attempted to assure that only purchased gas gets the premium contracts, not any of their own production on which they owe royalties to the U.S.

F. The results have been that royalties have been paid only on the basis of the lower spot market prices, and that Defendants have captured 100% of the profits from the premium contracts, without sharing any of it with the U.S. as royalty owner.

G. Defendants with premium contracts in various parts of the country have set up special groups or divisions to buy gas on the various spot markets for delivery into the premium contracts. They thus have attempted to assure that the U.S. as royalty owner is not paid on any of the premium contracts.

H. Defendants thus have used their control of the huge OCS and other federal gas royalty reserves of the U.S. to obtain aggregation premium prices for gas, without paying the U.S. its proportionate royalty part of such premiums.

I. The foregoing practice and scheme has operated as a fraud on the U.S. It violates the "gross proceeds" and "market value" requirements of royalty clauses and regulations, the "duty to market" requirements of regulations and case law, and the provisions of regulations requiring royalties to be paid on the "total consideration" received "directly or indirectly" by the lessee.

177. Underpayments Using Volumetric Production Payments.

A. A volumetric production payment ("VVP") is a relatively new financing instrument. It constitutes a right to receive a specified volume of production (e.g., 60 BCF of gas) from designated percentages of production from specific wells or leases, generally free of all costs.

It represents an interest in the wells or leases. It is in legal effect a limited, rather than perpetual, overriding royalty interest.

B. A VPP is a variation of the older production payments which represented a fixed dollar amount plus an interest equivalent (rather than a fixed volume of production), dischargeable out of a specified percentage of production from specific wells or lease. These were used to finance the purchase or development of producing properties because of income tax and financial statement advantages.

C. The buyer of a VPP pays cash up front and receives gas production over time. The producer-seller receives cash up front, usually based on a premium price for the gas above spot market prices, on which he pays no royalties.

D. Usually the VPP buyer is a financing middleman who is brought into the transaction by a producer who wants a lump-sum cash payment and a utility that needs to make monthly purchases of gas supplies over an extended period of time, and is willing to pay a premium for the long-term supply, payable only monthly. The VPP buyer, usually an affiliate or inside friend of the producer or utility or financing entity, is the middle-man who makes the deal work. He takes a profit on the difference between the discounted lump sum he pays for the VPP and the monthly premium price at which he sells the gas to the utility over the term the VPP remains in effect.

E. Defendants who have sold VPP have calculated royalties either by dividing the cash received for the VPP by the number of units of production received over time, or by disregarding the cash payment entirely, and calculating royalties on the basis of lower spot market prices at the times production occurs.

F. In the former case, the Defendant has underpaid royalties by at least a premium equal to the time value of the money received now instead of when production occurs; in the latter case, the Defendant has underpaid royalties both by such time value premium and the difference in gas price at which the VPP was sold and the lower spot market prices on which royalties were calculated.

G. This usage of VPPs to underpay gas royalties violates both the "gross proceeds" requirements of leases and regulations, and the requirement that royalty be calculated on the "total consideration" received "directly or indirectly" for gas sold.

178. Underpayments of Gas Royalties by "Swaps."

A. Defendants have used exchanges or "swaps" to underpay gas royalties owed the U.S. Each transaction is different, but the following hypothetical example illustrates how this scheme works:

B. Assume a Louisiana OCS lease operator also owns an Indian Lease in Oklahoma. The operator's marketing affiliate has a non-sourced contract obligation to sell gas to a local utility in Oklahoma at a price that is currently less than the Oklahoma spot price. The Oklahoma spot price is equal to the Louisiana spot price, but both are below the premium-priced contract the affiliate has to sell non-sourced gas to a Louisiana end user.

C. The Louisiana and Oklahoma spot market prices being equal, the producer Defendant and its affiliate "swap" or exchange the OCS gas for an equivalent volume of Oklahoma gas. The former OCS gas is delivered to the Oklahoma utility. Royalty is paid to the U.S. on the Louisiana OCS lease at the low contract price received from the Oklahoma utility, allegedly being the "gross proceeds" from that sale to a "non-affiliated buyer with opposing economic interests" as specified in the DOI regulations.

D. The former Indian lease gas is sold on the Louisiana spot market by the marketing affiliate. Royalty is paid to the Indians on the spot market price, allegedly being the "gross proceeds" received from an unaffiliated buyer with opposing economic interests.

E. The affiliate then uses the proceeds of this spot market sale to buy gas which it delivers into the premium-priced contract with the Louisiana end-user, at a profit.

F. No royalty is paid on the premium price either to the Louisiana OCS lease or the Indian lease in Oklahoma. The burden of the affiliate's unfavorable contract with the Oklahoma utility has been shifted to the U.S. as OCS royalty owner. The Indians did not receive the Louisiana premium for which their gas was indirectly sold.

G. This scheme violates the provision of the OCS lease (controlling over any inconsistent regulations arguably complied with) requiring that royalty must be paid on "not less than market value," *i.e.*, at least the Oklahoma spot price.

H. Disregarding the affiliates deals, there also has been a violation of the controlling OCS lease provision that royalty must be paid at not less than market value, *i.e.*, at least the Louisiana spot price.

I. The Indians, whose typical Indian lease provides for royalty at the higher of market value or gross proceeds, have been underpaid because they did not receive the "gross proceeds" received directly or indirectly for their gas, *i.e.*, the Louisiana premium price paid by the end-user there.

179. Underpayments of Gas Royalties by Fictional "Backhauling."

A. Defendants have underpaid gas royalties by the fictional device of "backhauling." "Backhauling" is the fictional transportation of gas upstream against the flow of the pipeline. It is a device used to reduce royalty payments, usually by fictitious transportation deductions, sometimes accompanied by market price underpayments. The following hypothetical example illustrates how the scheme can work:

B. Florida Gas Transmission Company operates a large gas pipeline which runs downstream from the Texas Gulf Coast through Louisiana, Mississippi, and Alabama near their coast lines to Florida. It serves the Florida gas market and markets along the line.

C. Sonat produces gas in East Texas just upstream of the Houston Ship Channel, a negligible location price differential (transportation cost) from that marketing center. Enron produces OCS gas in the Mobile Bay area offshore Alabama. Sonat has a buyer for gas downstream near its traditional headquarters and marketing area in Alabama, and close to where Enron's OCS gas comes ashore. Enron, through its HPC subsidiary, has a buyer for its OCS gas upstream at the Houston Ship Channel near its headquarters in Houston.

D. The pipeline, for a very small "backhauling" fee (or no fee at all in this example because the Florida Gas pipeline is actually owned 50-50 by Enron and Sonat), exchanges the gas of the parties, so that the former Sonat gas is delivered to Enron's buyer at the nearby Houston Ship Channel, and the former Alabama OCS gas of Enron is delivered to Sonat's buyer in nearby onshore Alabama.

E. But both Enron and Sonat, in computing gas prices for royalty payment purposes, may deduct the very substantial transportation charges (location differentials) that would

have been incurred if the gas they produced had actually moved from the points of production to the distant points of contract delivery to the buyers.

F. Alternatively to deducting fictitious transportation costs, Florida Gas may charge Enron and an excessive "backhauling" fee which Enron deducts from its royalty payments, and Florida Gas may charge Sonat an equal amount for the fictitious transportation of gas from Texas to Alabama, which Sonat deducts for royalty payment purposes. Since Sonat and Enron own the pipeline equally, there is no real economic cost involved.

G. Frequently the spot market gas price at the Houston Ship Channel is appreciable higher than the spot market price at the Henry Hub in Louisiana, the market center both for NYMEX gas futures and the leading spot market center for OCS gas. If that were the case here, Enron might pay DOI-MMS royalty on the basis of the lower spot market price at the nearer Henry Hub market center (less the location differential between Henry Hub and the onshore Florida Gas pipeline connection in Alabama for Enron's OCS gas and less OCS offshore transportation costs—unlawful under the controlling federal statutes), even though Enron actually received the higher spot market price at the Houston Ship Channel without such transportation costs.

H. These backhauling arrangements may not show up in a conventional MMS audit and are difficult for it to detect. Forensic audits under the jurisdiction of this Court are required to detect this and other fraudulent gas/NGL royalty underpayment devices by Defendants.

180. Royalty Underpayments by Gas/Electricity Swaps and Other Exchanges of Gas/NGL for Other Commodities or Financial Instruments.

A. In some areas of the nation, particularly those served by nuclear power plants or distant from fossil energy sources, electricity costs more than \$6.00 per MMBTU.

B. Chevron owns Gulf OCS leases, and sells the gas production to its NGC affiliate for (just as one reasonable example) \$2.00 per MMBTU. Chevron pays royalty to the U.S. on this \$2.00 price.

C. NGC then may pay to have the gas transported to an electric generating plant in (for example) New Hampshire, pay a small fee to the utility plant owner to convert the gas to electricity, and pay the utility another small fee to carry the electricity over its transmission lines to customer, who pays Chevron NGC affiliate the equivalent of \$6.00 per MMBTU for the electricity.

D. All of this may have been accomplished by an NGC gas trader and an NGC electricity trader sitting next to each other in NGC's trading room in Houston, with no capital investment by Chevron or NGC in gas pipelines, electric generating plants, or electric power lines. By comparison, Chevron and the other major integrated oil companies have huge investments in refineries used to convert crude oil to gasoline, to justify not paying oil royalties based on refined values.

E. In the foregoing example, Chevron has underpaid royalties in breach of its duty, expressed both in DOI-MMS regulations and case law, to market its OCS gas production for the mutual benefit of Chevron and the U.S. at no cost to the U.S. as royalty owner and at the highest practical price.

F. Chevron also has violated the provisions of the regulations requiring royalties to be calculated and paid on the basis of the re-sale price by the affiliate, rather than the sales price by the producer-lessee to its affiliate.

G. Chevron also has violated the requirements of its lease and of the regulations requiring royalties to be calculated on the "gross proceeds" and "total consideration" received by it "directly or indirectly" for its OCS gas production.

H. Defendants also have exchanged gas and NGL for other commodities, futures contracts, and other financial instruments or currencies without paying royalties on the gross proceeds realized by them or their affiliates from such transactions, in violation of the same legal requirements referred to above.

I. These exchanges, swaps and financial transactions are difficult for MMS to detect in conventional audits. Forensic audits by CPA masters under the jurisdiction of this Court are necessary to protect the against these and other types of fraud.

181. Gas Royalty Underpayments from "Buy-Outs" and "Buy-Downs."

A. Section 102 of the Natural Gas Policy Act of 1978 authorized higher interstate prices for "new" gas and certain other gas produced from the OCS. This legislation was in response to the higher-price intrastate gas market which had developed in the aftermath of the disastrous 1954 decision of the 'Supreme Court in the Phillips case, and the consequent utility-type cost regulation of gas producers under the Natural Gas Act. This had led to critical shortages of gas supply to the interstate market, because gas producers had confined their sales to the unregulated intrastate market.

B. Beginning in 1978, many gas buyers entered into long-term, high-priced "Section 102" contracts with Defendants covering both OCS and other federal leases. To meet the

competition from the high-priced, unregulated intrastate market, these Section 102 interstate gas contracts often necessarily provided for prices in excess of \$4.00 per MCF or MMBTU, and sometimes as high as \$12.00.

C. Then, when the entire gas market fell below \$2.00 following the "oil bust" beginning at the end of 1985, the gas purchasers were left "stranded" with high "Section 102" gas purchase contracts far above current market prices.

D. Both customers and shareholders of gas purchasers complained, as did local and state regulatory authorities. Much litigation ensued, with the buyers attempting to avoid their contracts on "force majeure" and other grounds.

E. Most of these controversies and lawsuits were settled in the late 1980s and early-to-mid 1990s. The buyers were allowed to "buy-out" or "buy-down" their Section 102 gas contracts to lower prices by making large cash payments to the producer-seller Defendants. By compromises and settlements, the Section 102 contracts were either terminated ("buy-outs") or else were modified to provide lower prices ("buy-down").

F. Defendants consistently did not share their "buy-out" or "buy-down" cash payments with the U.S. as royalty owner, despite the fact that the Defendants had released the rights of the U.S. as royalty owner to receive payment for its share of the gas at the high Section 102 contract price, and despite the fact that the cash payments were attributable in proportionate part to the U.S. royalty share of the gas covered by, and released from, the contract.

G. Failure to exclude the U.S. royalty share of gas production from these buy-outs and buy-downs, or else to pay the U.S. its proportionate part thereof, constituted a violation of the

Defendants' marketing covenant, expressed both in DOI-MMS regulations and case law, to use due diligence to obtain the highest price practical for the royalty share of production.

H. To avoid claims by the U.S. as royalty owner, Defendants have failed to disclose, and in fact concealed, the existence of the buy-outs and buy-downs from the U.S.

I. Case law has established that these cash payments must be allocated to future production purchased by the same buyers, and added to U.S. royalty payments on such future production. Defendants have failed to do this, and so have underpaid their gas royalties on production subsequent to such "buy-outs" and "buy-downs."

182. Unlawful Deductions for Transportation Costs.

A. Defendants have underpaid gas/NGL royalties by taking deductions from royalty payments on OCS and other federal leases for transportation costs and transportation charges paid to third parties. This is unlawful.

B. OCS and Indian leases require that royalties be calculated on not less than "gross proceeds." The term "gross" legally means the "entire amount, without any deductions."

C. Prior to 1988, DOI-MMS regulations had no provisions allowing deduction of transportation costs. As to OCS and Indian leases issued prior to the effective date of the 1988 Regulations, there is no basis in either the leases themselves or the regulations for deductions from royalty payments for costs of transportation when royalties are paid in value rather than in kind.

D. The 1988 Regulations purport to authorize deductions from gas/NGL royalty payments for certain of the lessee's "reasonable, actual" transportation costs.

E. These regulations are inconsistent with the requirements of OCS and Indian leases requiring royalty payments to be calculated and paid on not less than gross proceeds, *i.e.*, the entire proceeds without any deductions.

F. In this situation, the OCS and Indian lease provisions control over the inconsistent regulations, as provided in the regulations themselves. Therefore, no deductions can be taken for costs of transporting gas/NGL produced on OCS or Indian leases.

G. 30 C.P.R. Section 150.150(b) expressly provides that if the specific provisions of a lease are inconsistent with any regulation, the lease controls. The 1988 Regulations purporting to authorize deductions of transportation costs from royalty payments are clearly inconsistent with the provisions of the OCS and Indian leases providing that royalties shall be calculated on the gross proceeds, *i.e.*, the entire proceeds without any deductions.

H. Even if the transportation deduction provision of the 1988 Regulations were effective, Defendants have underpaid gas/NGL royalties by taking deductions in excess of "actual" and "reasonable" transportation costs.

I. Transportation deductions from gas/NGL royalties are also unlawful for an entirely different reason. The U.S. oil and gas royalty interest is, by legal definition, free and clear of all costs of production.

J. The term "production" is a defined term under the Outer Continental Shelf Land Act ("OCSLA"). Paragraph (m) of Section 2 of OCSLA as added in 1978 provides as follows:

(m). The term "production" means those activities which take place after the successful completion of any means for the removal of minerals, including such removal, field operations, transfer of minerals to shore, operations monitoring, maintenance, and work-over drilling. (underlining added).

43 U.S.C. Sec. 1331(m).

K. Thus, the costs of transporting gas/NGL from OCS leases to shore is, by the controlling statute, no more deductible from royalty payments than are the costs of field operations, operations monitoring, maintenance, or work-over drilling. All of these activities are included in the statutory definition of "production." Production costs can never be charged to a royalty interest; a royalty interest is, by legal definition, free of all costs of production.

L. The Federal Oil and Gas Royalty Management Act of 1982 ("FOGRMA"), applicable to both federal on shore and OCS production, expanded the definition of "production" "for the purposes of this Act" to include any "transfer of oil or gas off the lease site", without limiting such transfer of production just "to shore" and with no other distance limitations. 30 U.S.C. Sec. 1702(13).

M. The purpose of FOGRMA was "(1) to clarify, reaffirm, expand and define the responsibilities and obligations of lessees . . . in the transportation and sale of oil and gas. . . ." 30 U.S.C. Sec. 1701(b). The legislative history shows the primary concern of Congress was royalty underpayments to the U.S. Government. 1982 U.S. Code Cong. & Admin. News pp. 4269-72.

N. The inconsistent 1988 Regulations allowing deductions for transportation costs must yield to these clear expressions of Congressional intent. Chevron U.S.C., Inc. v. Natural Resources Defense Council, 467 U.S. 837, 843 (1984). The regulations themselves provide that if the specific provisions of any statute are inconsistent with any regulation, then the statute governs.

O. Even if, or to the extent, any transportation costs were or are deductible, Defendants have underpaid gas/NGL royalties by improperly characterizing gathering costs, not

deductible even under the regulations, as transportation costs, and by deducting amounts in excess of "actual" and "reasonable" transportation costs.

183. Underpayments on Refunds.

A. Defendants have underpaid gas/NGL royalties by failing to make royalty payments on refunds and retroactive downward price adjustments of charges by pipeline carriers and others.

184. Underpayments on Upward Price Adjustments. Defendants have underpaid gas/NGL royalties by failing to make royalty payments on upward payment adjustments made by gas/NGL purchasers subsequent to the original payments to Defendants on which royalties were calculated and paid.

185. Payments on Lower Instead of Higher Market Values and Gross Proceeds. OCS and Indian leases require payment of gas/NGL royalties on the higher of (1) market value and (2) gross proceeds. Defendants under such obligations have made arbitrary calculations of market values (often based on distressed spot prices), and have paid gas/NGL royalties based on such calculated market values, notwithstanding they have actually sold their production, either directly or through affiliates, at higher prices. Thus, Exxon and Chevron, as just two examples, have sold gas directly to LDCs and end-users at city-gate prices or above. But they have not paid royalties based on the gross proceeds of such sales, but rather at lower prices reflecting calculations (often erroneous) of market prices in the fields where the gas was not in fact sold.

186. Underpayments of Royalties on Sulfur Extracted From Gas.

A. Defendants also have utilized some of the fraudulent devices and schemes described above, and others, to underpay royalties owed to the U.S. on production of sulfur extracted at processing plants from gas produced from federal leases, and extracted by the Frasch process from OCS leases offshore Louisiana.

B. Particular instances of fraudulent underpayments of royalties on sulfur extracted from gas at gas processing plants include all gas production from federal leases from which gas production has been processed for removal of sulfur at the plants operated by Amoco in Uinta, Sweetwater, Park, Natrona, and Fremont Counties, Wyoming, and in Eddy County, New Mexico, the plant operated by Chevron at Carter Creek, Wyoming, the plants operated by Exxon in Lincoln and Sweetwater Counties, Wyoming and in Escambia and Mobile Counties, Alabama, the plant operated by Mobil in Mary Ann Parish, Louisiana, the plant operated by Marathon in Park County, Wyoming, and all gas and sulfur produced from OCS leases.

187. Underpayments of Royalties on CO2 Extracted from Gas.

A. Defendants also have utilized some of the fraudulent devices and schemes described above, and others, to underpay royalties owed to the U.S. on production of carbon dioxide (CO2) contained in gas produced from federal leases.

B. Particular instances of fraudulent underpayments of royalties owed on CO2 contained in gas produced from federal leases include all gas production from federal leases operated by Amoco, Amerada Hess, Shell, and Exxon covering those federal lands in Union, Harding, and Quay Counties, New Mexico, included in the 1,035,855 acre Bravo Dome Unit (as to which such Defendants have charged the U.S. as royalty owners with costs of production and have used the CO2

themselves or sold it to affiliates at below-market values), all production of gas from federal leases processed at the plant operated by Amoco in Sweetwater County, Wyoming, and all gas production from federal leases in Colorado from which CO2 is extracted at processing plants in that state, including particularly the plant operated by Shell in the McElmo Dome Field in Montezuma County, Colorado northwest of Durango and the plant in the Sheeps' Mountain Field in Huerfano County, Colorado near Walsenberg, Colorado, operated by Atlantic Richfield Company.

188. Since at least 1986, all of the Defendants have engaged, and continue to engage, in some or all of the above fraudulent royalty payment practices, thereby damaging and continuing to damage the United States.

189. The false statements described above constitute false and/or fraudulent claims.

CONSPIRACY IN RESTRAINT OF TRADE AND TO DEFRAUD U.S.

190. Defendants have combined and conspired among themselves to perpetrate the common fraudulent schemes and devices specified above. This illegal conspiracy has been part of a general and coordinated plan among Defendants to defraud the United States by underpaying the gas/NGL royalties legally owed to it.

191. All of the Defendants are engaged in the business or producing and selling gas and NGL. Most of the Defendants have marketing divisions or affiliates which are actively engaged in marketing gas and NGL. Many of the Defendants also are actively engaged in the business of buying, trading and selling gas and NGL. These compete with each other in the market to purchase available supplies of gas and NGL.

192. Since 1980, federal leases have accounted for more than 30% of the nation's domestic supply of gas and NGL. As a result, the U.S., as royalty owner with the unrestricted right to take in

kind and sell its royalty gas and NGLs, is the largest single owner of natural gas supplies and reserves available for contract purchase.

193. Many of the Defendants or their affiliates actively and aggressively compete with each other for the purchase of gas supplies much smaller than are and have been available from the U.S.

194. Despite these facts, since 1980, none of Defendants has made any substantial unsolicited offers to the U.S. to purchase any of its royalty gas and NGL from any federal lease operated by any other Defendant, even though all Defendants have known that the U.S., under the terms of its leases and the applicable statutes and regulations, at all time has had the unrestricted right to take in kind and sell for its own account such royalty share of gas and NGL.

195. There has been no competitive market for the royalty gas/NGL of the United States Government even though it is the largest single ownership source for gas/NGLs available for purchase in the nation.

196. This lack of competitive market is due entirely to the fact that Defendants have not made competing bids for the purchase of such U.S. royalty gas/NGL.

197. The total absence of such unsolicited competing bids is credible and convincing, if not irrefutable, evidence of a combination and conspiracy in restraint of trade and to defraud the U.S. through employment of the fraudulent underpayment schemes detailed herein.

198. Since at least 1980, there has been an illegal, express or tacit agreement or understanding among Defendants that none of them would unilaterally offer to purchase the U.S. royalty share of gas and NGL produced from any other Defendant's federal leases, or to compete with the lessee to purchase such royalty gas/NGL.

199. The purposes of such illegal agreement have been (1) to prevent the U.S. from obtaining the best available market prices for its royalty gas/NGLs, (2) to keep the prices for U.S. royalty gas/NGL low, (3) to prevent any competition for the U.S. gas/NGL, and (4) to assist all Defendants in the perpetration of the common fraudulent underpayment schemes specified above.

FACTS OF FRAUD UNKNOWN TO RESPONSIBLE U.S. OFFICIAL

200. None of the facts material to the rights of action asserted in this complaint were known or reasonably should have been known by the official of the United States with responsibility to act in the circumstances, more than three years prior to the date of filing this action.

201. As a result of the false and/or fraudulent claims being presented to the United States, the United States was damaged.

202. Damages to the United States include the amounts by which gas and NGL royalties have been calculated and paid on bases less than the entire gross proceeds actually accruing to the Defendants or their affiliates, directly or indirectly, for the gas and NGL actually produced or removed from the federal leases, or less than the market values thereof.

203. Calculated from the information which forms the basis of this complaint, the damages to the United States and the penalties under law may exceed Twenty Five (25) Billion Dollars.

COUNT I
(False Claims Act -- 31 U.S.C. Sec. 3729(a)(7))

204. The preceding factual statements and allegations are incorporated herein by reference.

205. Defendants have made, used, or caused to be made or used, false records or statements to conceal, avoid or decrease obligations to pay or transmit money or property to the Government, namely the gas/NGL royalties legally owed or payable to the Government.

206. These false and fraudulent records and/or statements have been made in documents including but not limited to Forms MMS-2014s, MMS-4054s, MMS-4109, MMS-4295 and other MMS statement forms. The number of such false statements may exceed 7,200,000.

207. Defendants' unlawful conduct is continuing in nature and so threatens to deprive the United States of its legal entitlement to its full gas/NGL royalty payments from federal leases.

COUNT II
(False Claims Act -- 31 U.S.C. s3729(a) (3))

208. The preceding factual statements and allegations are incorporated herein by reference.

209. Defendants have conspired to defraud the United States Government by getting false or fraudulent claims allowed or paid. Each and every Defendant has performed an overt act in furtherance of the conspiracy, and the Government has sustained damages as a result thereof.

COUNT III
(False Claims Act -- 31 U.S.C. Sec. 3729(a) (1))

210. The preceding factual statements and allegations are incorporated herein by reference.

211. Defendants have knowingly presented or caused to be presented to an officer or employee of the United States false or fraudulent claims for approval or payment. The United States has been damaged thereby, and the unlawful conduct is continuing.

COUNT IV
(False Claims Act -- 31 U.S.C. Sec. 3729(a) (2))

212. The preceding factual statements and allegations are incorporated herein by reference.

213. Defendants have knowingly made, used, or caused to be made or use, false or fraudulent claims paid or approved by the Government, to its damage which is continuing.

REQUEST FOR APPOINTMENTS OF MASTERS

214. Because (1) the issues with respect to computation of damages are complicated and difficult, (2) the amounts of money involved are very large, and (3) Defendants have concealed their frauds, Relator requests, pursuant to Fed. Civ. P. 53, the appointment of a special master or masters for each Defendant who may employ independent firms of Certified Public Accountants to examine and audit all books and records of each Defendant and its affiliates relating to the production and sale or removal of gas and NGL from federal lands.

DEMAND FOR JURY TRIAL

215. Relator demands a trial by jury.

PRAAYER

WHEREFORE, PREMISES CONSIDERED, Relator, on behalf of himself and the United States, requests

A. That Defendants be cited to appear and answer, that special masters be appointed, and, upon final trial or hearing, that judgment be awarded to Relator and the United States and imposed on Defendants, jointly and severally, for

- (i) all actual, incidental and/or consequential damages sustained by the United States (in the form of underpaid gas, NGL, sulfur and CO2 royalties),
- (ii) treble damages pursuant to 31 U.S.C. Sec. 3729(a),
- (iii) civil penalties for each false statement pursuant to 31 U.S.C. Sec. 3729(a),
- (iv) Post-judgment interest at the highest legal rates, where applicable.

B. That Relator

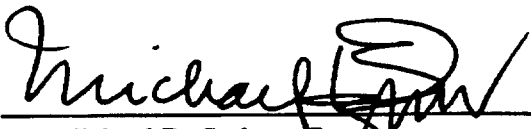
- (i) be awarded reasonable and necessary attorneys' fees, litigation expenses and court costs through the trial and any appeals of this case;

- (ii) be awarded an amount for originating and Prosecuting this action and collecting the civil penalties and damages, which shall be not less than 25% and not more than 30% of the proceeds of the action or settlement; and
- (iii) be awarded post-judgment interest at the highest legal rates, where applicable.

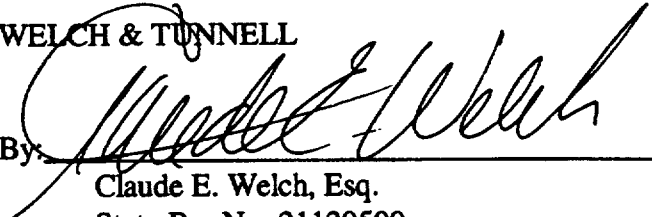
C. That he and the United States be granted such other and further relief, both at law and in equity, to which they are justly entitled.

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